

Message Text

SECRET

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ACTION SS-30

INFO OCT-01 ISO-00 /031 W

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R 280300Z MAY 74

FM AMEMBASSY PHNOM PENH

TO SECSTATE WASHDC 6253

S E C R E T SECTION 1 OF 2 PHNOM PENH 7328

EXDIS

E.O. 11652: GDS

TAGS: EAID, EFIN, CB

SUBJECT: DISCUSSION OF ECONOMIC PROBLEMS WITH PRIME MINISTER

1. AT MAY 27 MEETING I RAISED TWO ECONOMIC PROBLEMS WITH PRIME MINISTER: NEED FOR ADDITIONAL DEVALUATION OF RIEL AND INCREASING CEILING OF KHMER NATIONAL BANK ADVANCES TO GKR.

2. NEED FOR FURTHER DEVALUATION.

(1) I CALLED PRIME MINISTER'S ATTENTION TO RECENT MISSION LETTER TO MINISTER OF FINANCE WHICH CONCLUDES THAT RESULTS OF SECOND MONTHLY BUDGET REVIEW FOR PERIOD ENDING APRIL INDICATES NEED FOR ANOTHER DEVALUTION. I EXPLAINED THAT ECONOMIC OUNSELOR HAD ALREADY DISCUSSED THIS MATTER WITH MINISTER OF FINANCE BUT THAT I WISHED TO ALERT HIM TO THIS PROBLEM BECAUSE SUCH A DECISION NEEDS BOTH CABINET AND EXECUTIVE COUNCIL APPROVAL AND AS PRIME MINISTER HE HAD TO TAKE THE LEAD. TO ALLAY SOME OF HIS FEARS, I ADDED THAT OUR ECONOMIC EXPERTS ARE CONVINCED THAT IMPACT ON PRICES FROM DEVALUTION WILL BE MINIMAL. ACCORDING OUR ECONOMISTS, IMPORTED GOODS ARE ALREADY BEING SOLD IN PHNOM PENH AT PRICES BASED ON BLACK MARKET EXCHANGE RATE. HENCE WE BELIEVE DEVALUAION WILL ABOVE ALL SQUEEZE OUT THE EXCESSIVE PROFITS IMPORTERS ARE PRESENTLY REAPING FROM ARTIFICIALLY LOW RATE. I ALSO SAID THAT I HAD WORD THAT WASHINGTON FAVORED ANOTHER SIGNIFICANT EXCHANGE RATE

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ADJUSTMENT (STATE 110546).

(B) HAVING ALERTED THE PRIME MINISTER TO THE PROBLEM, I THEN EXPRESSED SYMPATHY FOR POLITICAL PROBLEMS WHICH MIGHT ARISE FROM SUCH AN ACT. TO MINIMIZE ADVERSE REACTION FROM THOSE WHO HERETOFORE HAVE BEEN MOST VOCAL OPPONENTS OF DEVALUATION (NATIONAL BANK AND IMPORTERS) I SUGGESTED THAT GOVERNMENT MIGHT WANT TO LINK TIMING OF DEVALUATION TO VISIT OF IMF OFFICIALS WHO ARE EXPECTED PHNOM PENH MIDDLE OF JUNE. I SAID THAT I UNDERSTAND FROM WASHINGTON THAT IMF VISITORS (CHABRIER AND HANDY) SHARE OUR VIEW OF THE DANGERS OF OVERVALUED EXCHANGE RATE IN KHMER REPUBLIC. IN SHORT, PRIME MINISTER MAY WISH TO USE PRESENCE OF IMF TEAM IN PHNOM PENH TO PUSH THROUGH ANOTHER DEVALUATION, SOMEHOW CREATING IMPRESSION THAT GKR IS MERELY RESPONDING TO TECHNICAL ADVICE PROFFERED BY HIGHLY REGARDED INTERNATIONAL ORGANIZATION RATHER THAN PRESSURE OF AMERICAN GOVERNMENT. PRIME MINISTER LIKED IDEA OF ENVELOPING UNPOPULAR DEVALUATION WITH MANTLE OF UNASSAILABLE IMF REPUTATION AND PROMISED TO PURSUE MATTER FURTHER WITH MINISTER OF FINANCE, ALTHOUGH HE VOICED SOME RESERVATIONS ON ANOTHER EXCHANGE RATE ADJUSTMENT SO SOON AFTER THE LAST ONE AND AT TIME WHEN HIS GOVERNMENT IS UNDER CONSIDERABLE ATTACK IN NATIONAL ASSEMBLY FOR FAILURE TO CONTROL INFLATION.

3. INCREASING CEILING OF NATIONAL BANK ADVANCES TO GKR.

(A) I THEN CALLED PRIME MINISTER'S ATTENTION TO RECENT CONGRESSIONAL ACT PROHIBITING RELEASE OF LOCAL CURRENCY GENERATED UNDER PL-480 AGREEMENTS TO MILITARY BUDGET SUPPORT AFTER JUNE 30, 1974. FURTHER I POINTED OUT THAT STARTING JULY 1, 1974, PL-480 COMMODITIES WILL NO LONGER BE GRANTS MADE AVAILABLE FOR LOCAL CURRENCY RELEASED TO HOST GOVERNMENT BUT WILL BE SOLD FOR DOLLARS FINANCED BY LONG TERM, LOW INTEREST LOANS.

'B) UNDER THE CIRCUMSTANCES, I THOUGHT IT WOULD BE IN GKR'S INTEREST TO GET MAXIMUM RIELS RELEASED FOR KHMER MILITARY BUDGET BEFORE END OF JUNE 1974. HOWEVER, BEFORE WE CAN RELEASE COUNTERPART FUNDS, GKR MUST FIRST DEPOSIT LOCAL CURRENCY TO THE PL-480 ACCOUNT FOR COMMODITIES DELIVERED BUT WHERE BILLS HAVE NOT YET BEEN PAID. SO FAR GKR HAS BEEN UNABLE TO DRAW NECESSARY FUNDS FROM

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NATIONAL BANK. I EXPLAINED THAT RICE PRICES ARE SUBSIDIZED BY GKR AND THAT SUBSIDY PORTION NEEDS TO BE FINANCED BY GKR. NOT HAVING SUFFICIENT REVENUE, GKR MUST GO TO NATIONAL BANK FOR ADVANCES. HOWEVER, KHMER LAW DOES NOT PERMIT THE NATIONAL BANK TO ADVANCE MORE THAN 1.3 BILLION RIEL PER MONTH. FOR THIS ONE TIME OCCASION (MONTH OF JUNE), THE NEEDS OF THE GKR ARE MUCH GREATER THAN CEILING. I THEREFORE SUGGESTED THAT THE NATIONAL ASSEMBLY

INCREASE THE CEILING OF NATIONAL BANK ADVANCES TO THE GKR
TO AN AMOUNT COMMENSURATE WITH GKR NEEDS TO PROVIDE LOCAL
CURRENCY FOR THE BILLS ALREADY RENDERED FOR PL-480
COMMODITIES DELIVERED. THIS ACT WOULD INCREASE COUNTER-
PART FUNDS AVAILABLE BEFORE JUNE 30 WHICH COULD

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ACTION SS-30

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S E C R E T SECTION 2 OF 2 PHNOM PENH 7328

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LEGITIMATELY BE USED FOR KHMER MILITARY BUDGET SUPPORT
AND WOULD ALSO REDUCE THE FUTURE DOLLAR INTEREST PAYMENTS
ON PL-480 SHIPMENTS. I ALSO SAID THAT I HAD TAKEN UP
THIS MATTER INFORMALLY WITH PRESIDENTS NATIONAL ASSEMBLY
AND SENATE AS WELL AS WITH SIRIK MATAK AND HOPED THAT GKR
COULD ACT EXPEDITIOUSLY FOR REASONS CITED ABOVE.
(C) PRIME MINISTER REPLIED HE WILL CONSULT WITH MINISTER
OF FINANCE ON HOW TO GET QUICK ASSEMBLY APPROVAL FOR GKR
REQUEST TO INCREASE CEILING OF NATIONAL BANK ADVANCES.

4. COMMENT: I THINK PRIME MINISTER IS PRESENTLY VERY
SENSITIVE TO ASSEMBLY CRITICISM ABOUT HIGH PRICES AND I
EXPECT HIM TO TRY TO STALL ON DEVALUATION AND PERHAPS EVEN
HAGGLE ABOUT PERCENTAGE OF ADJUSTMENT. HOWEVER, HE KNOWS
THAT SOONER OR LATER HE MUST JUMP THE HURDLE SINCE THE
GOVERNMENT HAS AGREED TO LINK EXCHANGE RATE ADJUSTMENTS TO
ANTICIPATED BUDGET DEFICITS. THE INFORMAL VISIT OF IMF TEAM
MIGHT PROVIDE HIM WITH TIMELY SMOKE SCREEN TO TAKE UNPOPULAR
ACTION. AS FOR RAISING CEILING ON NATIONAL BANK ADVANCES,
I SEE NO REASON WHY KHMERS WOULD BALK SINCE THIS ACTION IS
VERY MUCH IN THEIR FINANCIAL INTEREST. ONLY OBSTACLE I SEE
IS TRADITIONALLY SLOW KHMER BUREAUCRACY WHICH MIGHT NOT
COMPLETE ACTION IN TIME TO MEET DEADLINE.
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